EMPEA Brief

First-time Funds in Emerging Markets

EMPEA

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This EMPEA Brief explores the state of the market for first-time private equity funds in emerging markets, with an underlying view that first-time funds and emerging managers are important to sustainable private sector development, and more specifically, to a healthy private equity ecosystem. This article draws upon EMPEA's insights into fundraising trends and GP and LP perspectives, as well as performance data from Cambridge Associates, to highlight challenges facing newer emerging markets private equity fund managers operating in the current environment.

Why Do First-time Funds Matter?

First-time funds, defined here as an asset manager's first private equity (PE) vehicle, have historically accounted for a significant share of fundraising activity in emerging markets (EM). Between 2008 and the first quarter of 2015, 286 first-time funds reached final closes on an aggregate US$45 billion, accounting for 30% of the number of funds with final closes and 15% of total capital raised during this time period. But their prominence in overall EM PE fundraising is not the only reason why first-time funds matter to the asset class.

For limited partners (LPs), the benefit of supporting first-time funds is tangible from an industry development perspective; new fund managers not only encourage a more diverse marketplace, they also address financing gaps in many underserved markets, contributing in a broader sense to sustainable private sector development. Of all funds that held a final close in 2014 at or under US$100 million—the smallest segment of the private equity market—53% were first-time funds. What's more, in some EM PE markets with fewer active players, first-time funds account for a significant share of the number of funds raised. This is most clearly illustrated in Sub-Saharan Africa, which boasts the highest percentage of first-time funds reaching a final close, at 78% of all funds in 2014.

Yet despite their contribution to the industry, EMPEA has anecdotally witnessed an increasing number of emerging managers that are unable to raise capital. Investing in first-time funds, as LPs interviewed for this brief noted, compounds the risk of investing in EM PE with the uncertainty associated with a first-time manager. Haydee Celaya, Co-founder and Chief Investment Officer at Avanz Capital, an investment firm that specializes in PE across emerging and frontier markets, reflects: "Some of the underlying concerns that LPs have about investing in a first-time manager are around the team itself: Can the partners live off the management fee? Is the carried interest sufficient to keep the investment team employed and interested? Are they going to survive or are they going to start losing people? The commitment of a first-time group is always a big question." While there are many types of emerging managers, ranging from first-time teams to spinouts, the fundraising environment, as examined in the next section, has been challenging for all.

In Summary

- **In recent years, fewer first-time EM PE funds have reached final closes, and those that have are smaller in size.** In 2014, only 28 first-time EM PE funds reached a final close, with a median size of just US$52 million. This represents both the lowest overall number and the smallest median size of first-time funds since EMPEA began tracking fundraising statistics in 2006 (see page 2).
- **Many LPs are favoring larger, more established managers.** The decline in first-time funds has coincided with an increase in commitments to more experienced funds, as well as a concentration of capital at the larger end of the market (see page 4).
- **First-time managers constitute a growing share of funds achieving a final close in Sub-Saharan Africa, while witnessing the biggest declines in Emerging Asia.** In an exception to the overall trend of fewer EM PE funds, first-time managers raised 78% of the number of funds holding a final close in Sub-Saharan Africa in 2014. In contrast, from 2013 to 2014 the number of first-time funds holding a final close in Emerging Asia fell from 19 to 10 (see page 5).
- **The profile of first-time funds has shifted, with sector-specific and VC vehicles each accounting for an increasing share of the number of first-time funds.** As the overall number of first-time funds reaching a final close has declined, the number of sector-specific first-time funds has remained steady. Similarly, and coinciding with a rise in VC investments across many EM PE geographies, 46% of all first-time funds in 2014 were VC, the highest percentage on record (see page 6).
- **LPs' preference for more experienced, larger EM PE funds indicates an underlying preference for what are perceived to be the highest risk-adjusted returns, not necessarily the highest returns.** Data from Cambridge Associates show that within the top quartile of EM PE funds, first-, second- and third-time funds have outperformed later-series funds. The same data also show that first-, second- and third-time funds have a larger spread between the top 5% IRR breakpoint and the bottom 5% than later-series funds (see page 7).
- **First-time teams present a very different investment proposition than spinouts or other teams that have worked together in the past.** Industry experts share their thoughts on this, as well as on navigating the fundraising trail and accessing capital (see page 11).

The State of the Market for First-time Funds

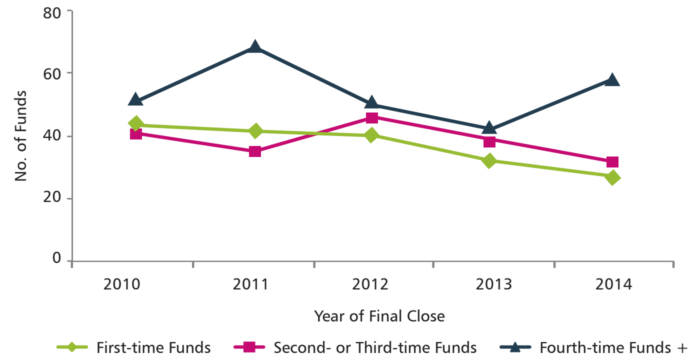
Since 2010, the number of first-time funds reaching a final close has steadily declined. In 2014, only 28 first-time EM PE funds reached a final close (see Exhibit 1), the lowest number on record since EMPEA began tracking fundraising statistics in 2006. While this should be contextualized within the overall decline in the number of EM PE funds closed, fund managers raising their first, second or third vehicle have been harder hit than fund managers raising their fourth fund or later, both in terms of number of funds and total capital raised. Since 2011, total capital raised by EM-dedicated first-time funds has declined on an annual basis, hitting an all-time low of US$2.8 billion in 2014 (see Exhibit 2), while second- or third-time funds have declined annually since 2012, both by the number of funds reaching a final close and by total capital raised.

So why are emerging managers raising less capital across fewer funds? Is the fundraising environment simply more challenging? While later sections of this brief implicate a confluence of factors on the fund manager side—including increasingly competitive geographies, a shift towards smaller VC vehicles in the overall composition of first-time funds and significant variance in performance—one broad factor likely contributing to this decline is LPs' growing appetites for larger and more experienced fund managers.

Development finance institutions (DFIs), rather than commercial LPs, are the largest supporters of first-time EM PE funds, likely for the reasons previously highlighted by Avanz Capital's Haydee Celaya—there are many unknowns with a first-time team. Hiran Embuldeniya, Managing Partner at Sri Lanka-focused private equity firm Ironwood Capital Partners, witnessed institutional investors' preference for more experienced fund

Exhibit 1: The number of fourth-time funds or higher jumped 38% from 2013 to 2014, while the number of first-time funds fell 15%

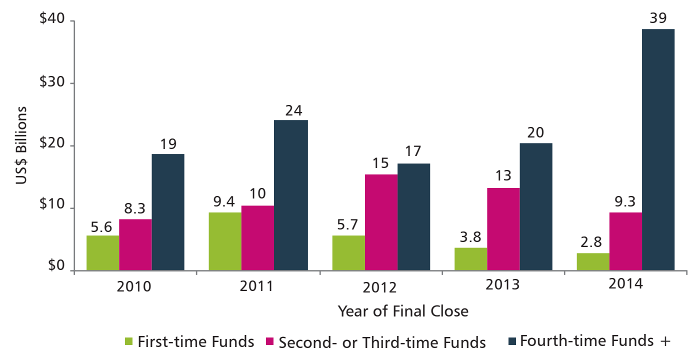
EM PE Fundraising by Year of Final Close, 2010-2014 (No. of Funds)



Source: EMPEA. Data as of 31 March 2015.

Exhibit 2: Total capital raised by first-time funds reaching a final close has declined annually since 2011

EM PE Fundraising by Year of Final Close, 2010-2014 (US$B)



Source: EMPEA. Data as of 31 March 2015.

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managers first-hand when raising the firm's debut fund in 2014: "We spoke with a host of funds of funds and other commercial institutional investors, and the feedback we received almost uniformly was that committing to a first-time fund manager in a new market like Sri Lanka is difficult, so let's talk again when you're on to fund two." What is notable here, however, is that according to EMPEA's statistics, many LPs appear not only to be looking past first-time funds, but also past second-and third-time funds.

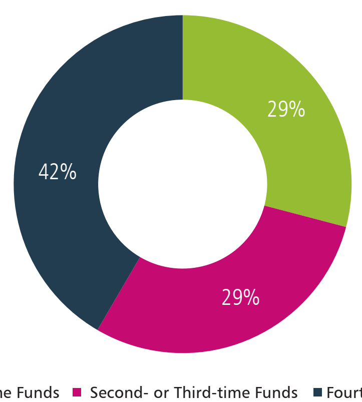
EMPEA's data reveal that more experienced fund managers (those on their fourth fund or later) are accounting for an increasing proportion of EM PE fundraising—perhaps expected in light of the recent decline in first-, second- and third-time funds. In 2014, fourth funds or later in a series reached final closes aggregating to US$39 billion, almost double the amount raised by fourth series funds or later in 2013. Moreover, 58 such funds closed in 2014, up from 42 in 2013.

The known universe of EM PE funds currently in the market also reflects LPs' preferences for more experienced managers. Of all the funds currently raising capital, an estimated 42% are fourth-time funds or later and 29% are first-time funds (see Exhibit 3). Not only are fewer first-time funds than later-series funds looking to raise capital, but—at least by slight margins—those that do, by some measures, tend to take longer and raise less capital than their more experienced counterparts. In one illustration of this, of all funds launched in 2011, 2012 and 2013, 23% of first-time funds have yet to hold a close, in comparison to 19% of funds that are fourth or later in a series (see Exhibit 4). Similarly, 56% of first-time funds launched in 2011, 2012 and 2013 have reached a final close, compared to 64% of funds that are fourth or later in a series.

Given these disparities, it is perhaps not surprising that fourth-time or later series funds are more prolific in number, and also raise more capital than first-, second- or third-time funds. This reflects not only a preference for firms with experience and significant track records, but also likely a preference for larger investment vehicles. First-, second- and third-time funds are not necessarily decreasing in number only because LPs may prefer more experienced managers with well-known, demonstrable track records, but likely due to a combination of LP preferences for both more experienced managers and for funds large enough to absorb increasing commitment sizes.

Exhibit 3: First-time funds account for 29% of all EM PE funds currently raising

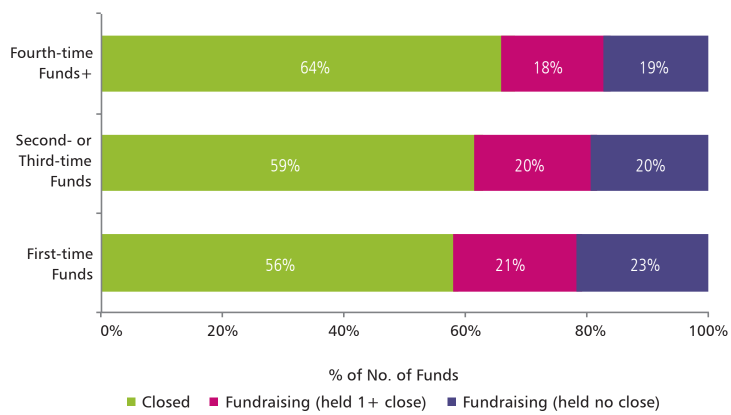
EM PE Funds in the Market by Fund Series (% of No. of Funds)



Source: EMPEA. Data as of 31 March 2015.

Exhibit 4: First-time funds launched in 2011, 2012 and 2013 are more likely to still be in the market than later series funds

Status of EM PE Funds Launched in 2011, 2012 and 2013 by Series (% of No. of Funds)



Source: EMPEA. Data as of 31 March 2015.

Methodology Note: "First-time funds" are defined in this brief as the first private equity-style investment vehicle—a closed-ended, fixed-life blind pool fund—to reach a final close from a given alternative asset manager. "Second- or third-time funds" are defined as the second or third funds from that same manager to reach a final close, while "fourth-time funds or later" refers to the fourth fund or later raised by the fund manager to reach a final close. In this brief "experienced" refers to managers that have raised four or more funds. For the analysis of funds currently raising capital, fund numbers are determined by interim close dates, or if there are none, by launch years. This approach is based on the number of funds raised by a single manager, irrespective of different strategies managed by the firm. For fund managers that previously invested via funds that were not institutional quality and subsequently raised institutional capital, all funds—both institutional and non-institutional—are counted when determining a fund's number within a series. For more on EMPEA's methodology, please visit empea.org.

Common Abbreviations:

EM – Emerging Markets
PE – Private Equity
VC – Venture Capital
GP – General Partner (fund manager)
LP – Limited Partner (fund investor)

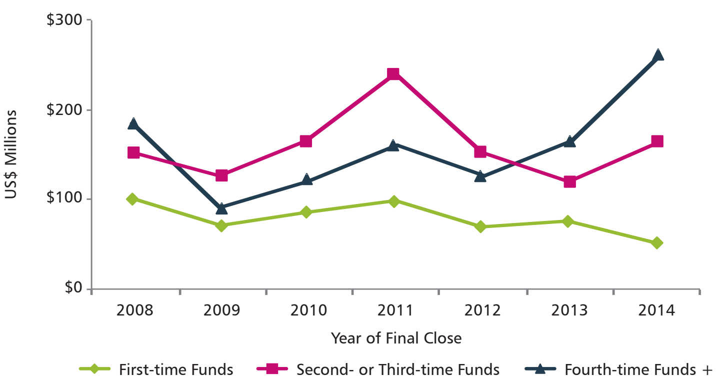
Diverging Fund Sizes

The dwindling overall number of first-time funds has coincided with a decline in their size at final close, for which the median has not topped US$100 million since 2008. In 2014, it hit an all-time low of just US$52 million (see Exhibit 5). In contrast, the median fund size of experienced funds with final closes reached US$260 million—the highest annual median on record. Taking a closer look at mean fund size, a similar trend has emerged, albeit revealing an even greater polarization between first-time and experienced funds. The mean fund size for experienced funds in 2014 jumped to US$692 million, well over the US$300 million to US$400 million mean-range of previous years, while the mean size of first-time funds hit a seven-year low of US$100 million.

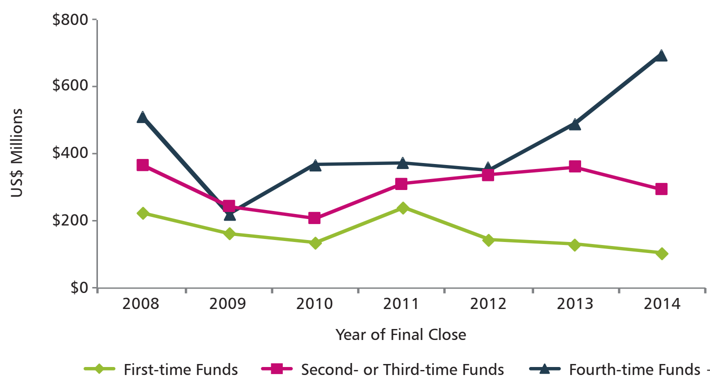
LP preference for experience is clearly part of this story, but it is important to note that the struggles of smaller funds in attracting commitments are not limited to first-time managers. EMPEA's data show that of all funds that have reached a final close in recent years, small funds (US$100 million and under) are experiencing a significant squeeze across the industry (see Exhibit 6). Certain EM PE geographies, however, present a more encouraging outlook for first-time funds.

Exhibit 5: The median and mean size of experienced funds has increased annually since 2012, while mean and median first-time fund sizes have declined

Median Size of EM PE Funds with Final Closes, 2008–2014 (US$m)



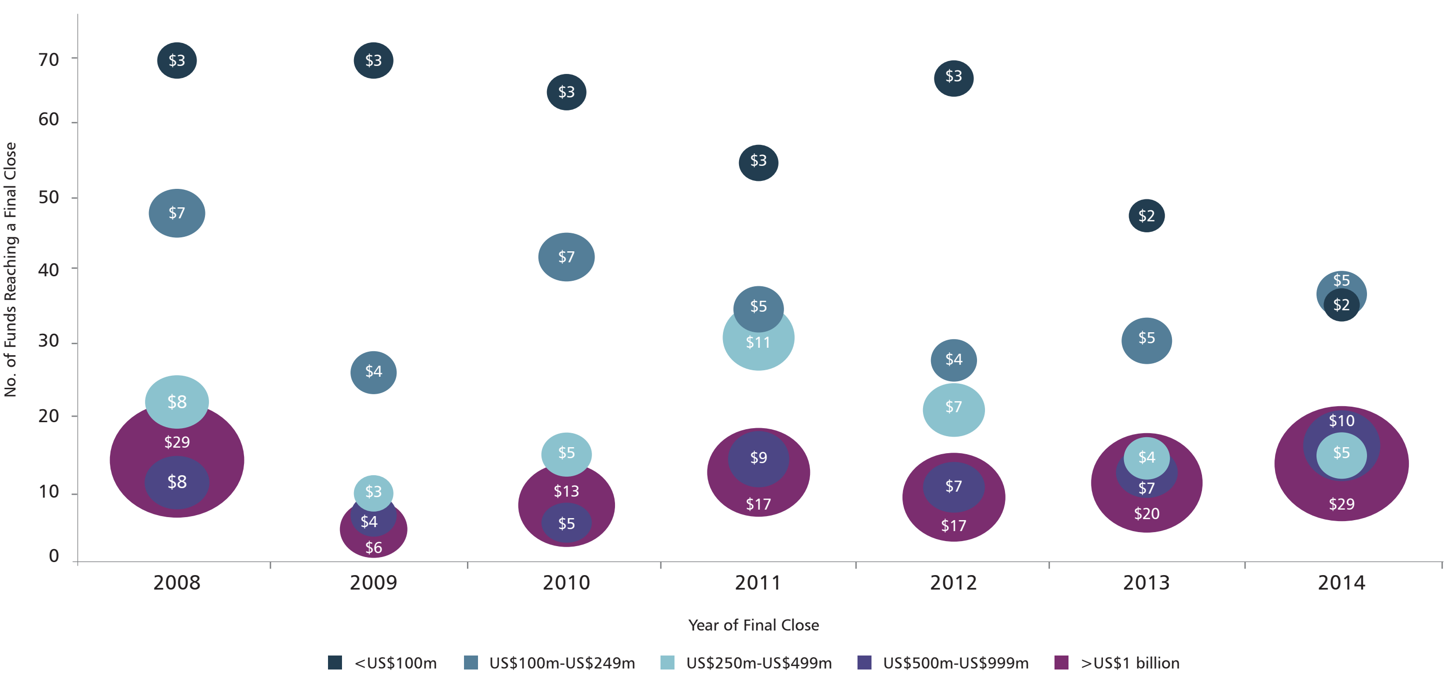
Mean Size of EM PE Funds with Final Closes, 2008–2014 (US$m)



Source: EMPEA. Data as of 31 March 2015.

Exhibit 6: As the number of EM PE funds holding a final close has fallen, capital has increasingly become concentrated in fewer, larger funds

Size Distribution of EM PE Funds with Final Closes, 2008–2014 (No. of Funds, US$B)



Note: Bubble size and label reflect total capital raised (US$Billion) by all funds with final closes within the respective fund size range.

Source: EMPEA. Data as of 31 March 2015.

First-time Funds Find Greater Success in Less-crowded Markets

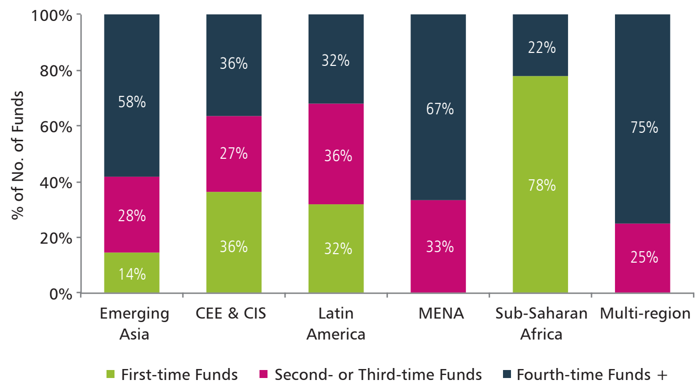
Geographic focus can be a crucial component of a first-time fund's success in achieving a final close. In less-crowded markets where LPs are looking to gain exposure, first-time fund managers tend to represent a larger share of the fundraising space. For example, in Sub-Saharan Africa—rated among the top three most attractive destinations for GP investment in EMPEA's 2015 *Global Limited Partners Survey,* and also identified as a region where the lack of established managers makes LP commitments challenging—first-time funds represented 78% of the number of funds holding a final close in 2014, and 54% of the total capital raised by funds with final closes (see Exhibit 7). This is also relevant in Latin America, as 32% of funds holding a final close in 2014 were first-time funds, and Latin America (excluding Brazil) was ranked as the most attractive region for GP investment in the 2015 Survey.

Conversely, in markets with a large number of active players, such as Emerging Asia, first-time funds tend to account for a smaller share of overall fundraising. Since 2008, the number of Emerging Asia-focused first-time funds has fallen significantly; only ten such funds reached a final close in 2014 (see Exhibit 8), including four each in India and China. Of all EM PE first-time funds reaching a final close, Emerging Asia's share dropped from 58% in 2013 to 36% in 2014 (see Exhibit 9). For some close observers, it may not come as a surprise to see an industry shakeout as the region had witnessed an influx of funds with erratic performance come to market in previous years. But the decline in first-time funds should also be viewed alongside an increase in large-scale Emerging Asia-focused vehicles.

Notably, Emerging Asia-dedicated regional vehicles—which tend to be later-series funds—have closed at record sizes in the last few years, a testament to commercial LPs'—especially sovereign wealth and U.S. pension funds—increased willingness to commit to the region. The rise of US$1 billion-plus funds in the region, and a decrease in smaller funds, has left an untapped opportunity in the middle and lower ends of the market. This is perhaps where first-time funds have been squeezed the most, but also where they continue to have an important role to play. Funds with more than US$1 billion to invest are less likely to provide financing to companies at the smaller end of the market, and many companies in Emerging Asia fit that profile. This market reality lends relevancy to smaller funds that are able to address financing gaps for small and mid-cap companies.

Exhibit 7: In 2014, 78% of funds holding final closes in Sub-Saharan Africa were first-time funds, compared to just 14% in Emerging Asia

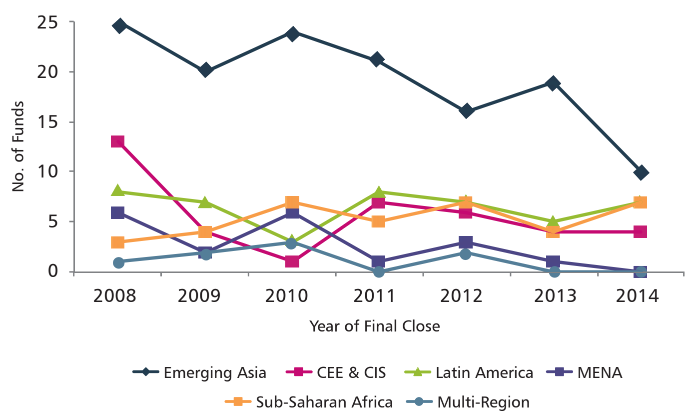
EM PE Funds Holding a Final Close by Geographic Focus, 2014 (% of No. of Funds)



Source: EMPEA. Data as of 31 March 2015.

Exhibit 8: The number of first-time funds holding a final close in Emerging Asia fell by 47% between 2013 and 2014

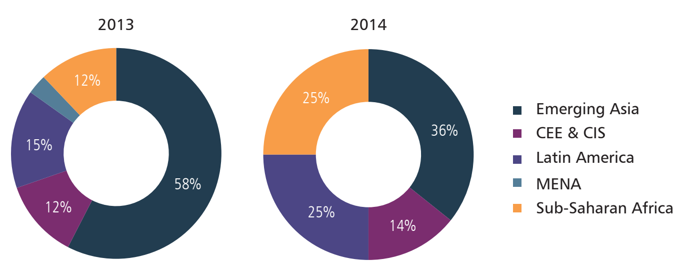
First-time EM PE Funds Holding a Final Close by Region, 2008–2014 (No. of Funds)



Source: EMPEA. Data as of 31 March 2015.

Exhibit 9: Sub-Saharan Africa accounted for one-quarter of all EM PE first-time funds in 2014, up from 12% in 2013

First-time EM PE Funds Holding a Final Close by Region, 2013 vs. 2014 (% of No. of Funds)



Source: EMPEA. Data as of 31 March 2015.

Shifting Profiles of First-time Funds

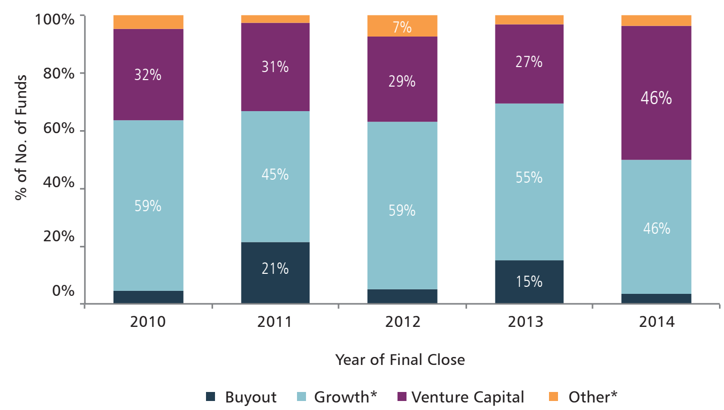
Across the emerging markets, but particularly in more crowded geographies, two profiles emerge for first-time managers that have been able to achieve a final close in recent years: those that found a niche sector play and those with a venture capital remit. Addressing the first of these, Andrew Affleck, Founder and Managing Partner of Southeast Asia-focused clean energy asset manager Armstrong Asset Management, notes: "One of the key decisions when we first talked about our strategy was geographic coverage. Before we came to market, there was no dedicated renewables fund focused purely on Southeast Asia." Notably, as the overall number of first-time funds has declined, the number of sector-specific first-time funds reaching a final close has remained relatively steady over the last seven years, with declines concentrated in funds with a generalist, non-differentiated approach (see Exhibit 10).

While sector-specific vehicles have worked well for some emerging managers, EMPEA's data also show that first-time managers have recently found success in addressing a market segment that has seen dramatic increases in both fundraising and investment levels in the last few years: venture capital (VC). Across emerging markets, VC funds accounted for an unprecedented share of the number of first-time funds reaching a final close in 2014. In total, 46% of first-time funds holding a final close in 2014 were VC funds, up from 27% in 2013 (see Exhibit 11).

Venture capital, however, is not yet a pan-EM phenomenon; rather, VC activity is concentrated in India and China, where the number of investible companies has increased in recent years. In Emerging Asia as a whole, seven of the ten first-time funds closed in 2014 were VC funds—a trend also seen in CEE and CIS and Latin America. In CEE and CIS, three of the four first-time funds closed in 2014 were VC funds, and in Latin America three of seven were VC. In markets where the VC industry remains nascent, traditional growth equity vehicles account for a larger share of first-time funds. This is true for Sub-Saharan Africa, in which all of the first-time funds that reached a final close in 2014 were growth vehicles.

Exhibit 11: Venture capital funds accounted for 46% of the total number of first-time funds reaching a final close in 2014, up from 27% in 2013

First-time EM PE Funds Holding a Final Close by Fund Type, 2010-2014 (% of No. of Funds)

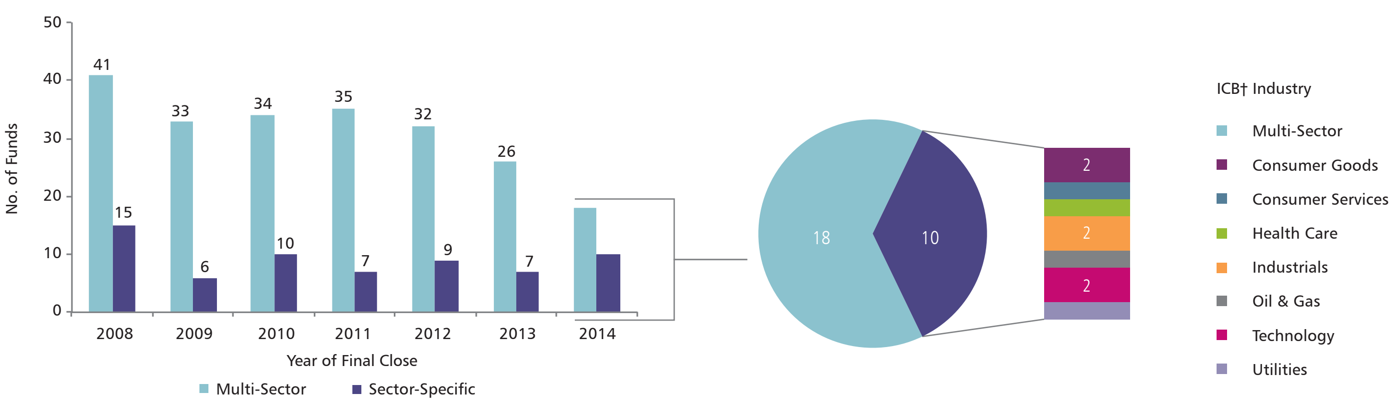


*Growth includes mezzanine funds. Other includes special situations and greenfield infrastructure funds.

Source: EMPEA. Data as of 31 March 2015.

Exhibit 10: First-time generalist, or multi-sector, funds with final closes have declined by number since 2011

First-time EM PE Funds with Final Closes by Sector-focus, 2008-2014 (No. of Funds)



† The Industry Classification Benchmark ("ICB") is owned by FTSE International Limited ("FTSE"). "FTSE®" is a trademark of the London Stock Exchange Group companies and is used by FTSE under license. FTSE does not accept any liability to any person for any loss or damage arising out of any error or omission in the ICB.

Source: EMPEA. Data as of 31 March 2015.

Assessing the Performance of EM PE Funds by Series

LPs commit to EM PE for a variety of reasons, but the leading drivers tend to be portfolio diversification and the potential to achieve outsized returns. Yet for commercial LPs that already include EM PE as part of their allocation strategy, first-time funds add a layer of risk and uncertainty that many would rather leave to the DFIs. These risks, however, should be considered alongside first-time funds' upside potential. As Haydee Celaya of Avanz Capital observes from her experience, "LPs that back new teams can make better returns than those who wait and come into a fund when the size has reached at least US$800 million to US$1 billion, or when the manager is raising a fourth or fifth generation fund, which are traits similar to the funds that LPs commonly find in developed markets."

The data confirm this sentiment. According to Cambridge Associates, the first, second and third funds from a given manager have historically outperformed later funds in a series (see Exhibit 12). In particular, second-time funds—still considered emerging to many LPs—achieved the highest median IRR of EM PE and VC funds in vintage years 2000 to 2009, indicating that getting into a manager's second or third fund can bring outsized returns with less team-related risk. Notably, the median fund size of EM PE funds increased as a fund series progressed, while the median IRR declined (after fund two). Thus, larger and later-series funds, historically, have correlated with lower returns, perhaps in part because fund managers that successfully raised smaller funds find it harder to consistently achieve the same outsized returns with larger pools of capital at their disposal.

Attractive return profiles for top performing first-, second- and third-time funds, however, are only one aspect of this story. The data also highlight their underlying riskiness, particularly for first-time funds. The top 5% of first-time funds in these vintage years recorded higher IRRs than the top 5% of second, third, fourth or later funds in a series, while the bottom 5% of first-time funds had a much lower IRR than the bottom 5% of funds later in a series (see Exhibit 13). So while some first-time funds with 2000 to 2009 vintage years have substantially outperformed later-series funds, many have significantly underperformed, underlining the inherent risk LPs face when assessing first-time managers. This variance may be one factor pushing LPs towards later series funds as they place greater value on what are perceived to be the highest risk-adjusted returns rather than the highest returns.

For fund managers, identifying LPs that are looking to allocate to firms with their specific risk/return profile, and then securing commitments, can be challenging endeavors. The next section highlights GP and LP perspectives and advice on navigating the fundraising trail.

Exhibit 12: Funds that come fourth or later in a series order have higher median fund sizes but lower median IRRs

EM PE Fund Size and Median IRR by Fund Series Order, Vintage Years 2000-2009 (Net to Limited Partners, as of 31 December 2014)

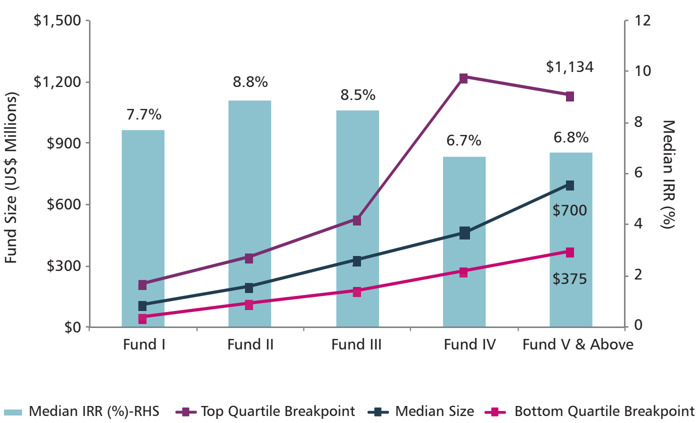
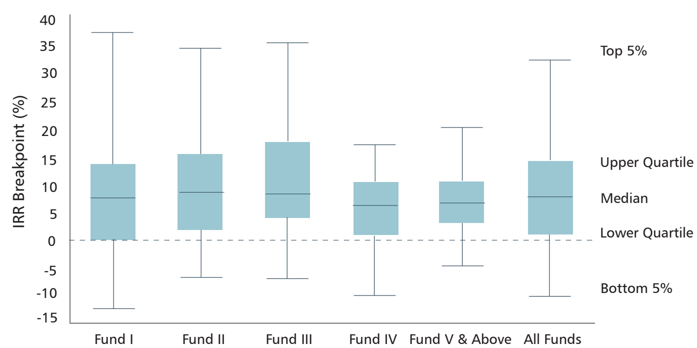


Exhibit 13: First funds in a series have the largest spread between the top 5% IRR breakpoint and bottom 5%

EM PE IRR by Fund Series Order, Vintage Years 2000-2009 (Net to Limited Partners, as of 31 December 2014)



Source: Cambridge Associates Private Investments database, as of 31 December 2014. IRR performance figures are net to Limited Partners. Fund order is determined as funds raised under the same strategy with a stable key investment team and does not include friends and family funds or other non-institutional funds.

Methodology Note: Per Cambridge Associates' methodology, fund order does not include previously raised non-institutional funds. The EMPEA methodology used in the rest of this publication differs slightly and can be found on page 2.

Navigating the Market for Emerging Managers

Shifting LP appetites, more competitive marketplaces and mixed returns all add up to an arguably more difficult fundraising environment for any EM PE fund manager currently raising capital. These challenges are particularly relevant for emerging managers. Underlying this discussion, however, is an important difference between first-time funds and first-time teams. The first fund raised by a new firm may not in fact be the first time that the team has worked together, and from an LP's perspective, this is an important distinction. Offering further nuance, Kelly Williams, Senior Advisor to EMPEA, comments, "In general, most LPs are cautious about investing in funds where the manager is managing capital for the first time. LPs rarely back managers who have not previously managed capital in an institutional manner. In this regard, I believe it's less important to consider whether the team has worked together before, and more important to consider whether the principals have experience investing for a return and acting as fiduciaries."

Of the various types of team origination stories—such as spinouts from existing firms, groups that work together in a specific industry segment or a family office that then looks to raise third-party capital—spinouts are anecdotally among the most common. As EMPEA's Kelly Williams discusses, "I believe spinouts are the most successful model these days. One factor that is likely behind the proliferation of spinouts is that spinouts not only have a track record, but that track record is often attributable to a group of people that already have LP relationships from their prior firm. Moreover, there is knowledge of the team in the marketplace. Together, these factors may mitigate one layer of risk for LPs as they evaluate these firms." Investing with a first-time team thus poses a different proposition than investing with a manager whose core team has a track record and has invested together before. For any team raising their first fund, and particularly those that are first-time teams, experts interviewed for this brief identified three main aspects of the fundraising process that can be crucial: forming a team, navigating the economics of being a first-time GP and honing a strategy.

To start, putting together a team of committed and incentivized individuals can help pave the way for a successful fundraise, particularly since team dynamics are often a primary concern for LPs considering commitments. In comparing funds raised by first-time teams to funds raised by established managers, Erik Bosman, Director of Private Equity at FMO – Netherlands Development Finance Company, observes: "If you have a second or third iteration of a fund, you will typically see a team that has gelled very well together, that has been through a cycle together and that has developed a common way of looking at deals. You don't know if you have that with a first-time fund manager." Similarly, in sharing his experience in raising a fund with a first-time team, Armstrong Asset Management's Andrew Affleck notes: "As a founder, you have to be prepared to share. If you want people to commit and take the fundraising success risk, you have to incentivize them because you can't begin without a core team, especially since a key part of the due diligence for first-time managers is how the team is incentivized and aligned."

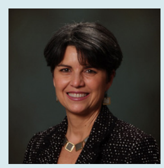
Advice for First-time Fund Managers

"Always budget for more. It always costs more, and it always takes longer. Everyone tells you that, and it's absolutely true."

–Andrew Affleck, Armstrong Asset Management

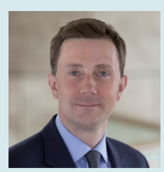
"Raise as much capital as you can, as quickly as you can and just get going. Don't worry about waiting to raise a US$50 million or a US$100 million fund right off the bat."

–Hiran Embuldeniya, Ironwood Capital Partners



"Passion is very important in this business because, for a first-time manager, the money is neither immediate nor obvious."

–Haydee Celaya, Avanz Capital



"Particularly for first-time funds, it's important to start small, focus on one or two geographies, and make sure that your strategy is coherent and clearly links to your background."

–Erik Bosman, FMO – Netherlands Development Finance Company

Second—and closely related to putting an incentivized team in place—is managing the balance sheet of a start-up with a small stream of management fee income that must be stretched to cover the essentials. Heinz Blennemann, Principal at Blennemann Family Investments, comments, "As an LP, we like to ensure that a first-time manager has sufficient fee income to keep the lights on and to afford top talent. Unlike a repeat manager, he or she may not have performance fee income from a prior fund. So as LPs, we do not insist on a (European-style) project-level performance fee, but accept a (American-style) deal-by-deal performance fee with a fee clawback."

Finally, choosing the right strategy can go a long way in helping a first-time team successfully raise capital. FMO's Erik Bosman observes, "What we like to see is people that have a real plan, a focus and a coherent strategy that they can actually articulate, and that could be anything. It could be sector. It could be style. It could be a combination of both." He also emphasizes, "If you want to do something that is not positioned as generic you need to have a very strong, compelling story as to why your narrow focus makes sense not only from a market perspective, but also for the investor. You need to be very careful in making sure you pick a theme that excites people."

In addition to these three components, all experts interviewed for this brief emphasized that a manager's commitment and passion for its firm's strategy, mission and geography are crucial for his or her long-term success. Susana Garcia-Robles, Principal Investment Officer at the Multilateral Investment Fund of the Inter-American Development Bank, reflects: "Out of the most successful funds that we invested in, a very clear profile emerged. These fund managers had worked or studied overseas and gained exposure to how venture capital worked in a developed market. They returned to their countries of origin with a lifetime commitment to replicating this experience in their home markets. Deep networks were a must for fundraising, sourcing a pipeline and exiting." But even if a fund manager has all these ingredients, identifying the right LPs and converting meetings into commitments are arguably the biggest challenges for GPs in the market.

Exhibit 14: Sampling of EM PE First-time Funds Achieving a Final Close, 2013-Q1 2015

Fund Manager	Fund Name	Fund Type	Geographic Focus	Currency	Total Capital Raised (US$m)	Date of Final Close
ON Ventures	ON Ventures Mexico I	Venture Capital	Latin America	MXN	7	Mar-15
BPM Capital	BPM Mezzanine Fund	Mezzanine	CEE & CIS	EUR	81	Jan-15
MGM Innova Capital	MGM Sustainable Energy Fund	Venture Capital	Latin America	USD	63	Jan-15
Unicorn Capital Partners	Unicorn Capital Partners Fund I	Buyout	Commonwealth of Independent States (CIS)	USD	100	Dec-14
Ironwood Capital Partners	Ironwood Capital Partners Fund	Growth	Sri Lanka	USD	30	Dec-14
Amethis Finance	Amethis Finance Fund	Growth	Sub-Saharan Africa	USD	530	Jun-14
Schulze Global Investments (SGI)	Schulze Global Ethiopia Growth and Transformation Fund I	Growth	Ethiopia	USD	87	Mar-14
Advanced Finance and Investment Group	Atlantic Coast Regional Fund	Growth	Sub-Saharan Africa	USD	122	Feb-14
Banyan Capital	Banyan Partners Fund I	Venture Capital	China	USD	206	Jan-14
Velum Ventures	Velum Early Stage Fund I	Venture Capital	Colombia	USD	11	Jan-14
Armstrong Asset Management	Armstrong South East Asia Clean Energy Fund	Infrastructure	Southeast Asia	USD	164	Nov-13
Kedaara Capital	Kedaara Capital I	Growth	India	USD	540	Nov-13
Decheng Capital	Decheng Capital China Life Sciences Fund I	Venture Capital	China	USD	125	Jun-13
RM Capital Partners	RMCP Malaysia Fund	Growth	Malaysia	MYR	36	May-13
Asian Healthcare Fund	Asian Healthcare Fund	Venture Capital	India	INR	40	Jan-13
Creador	Creador I	Growth	Asia, India, Indonesia, Malaysia	USD	132	Jan-13
Mediterra Capital	Mediterra Capital Partners I	Buyout	Turkey	EUR	230	Jan-13

Source: EMPEA. Data as of 31 March 2015.

Accessing Capital

The journey from a fund's first days on the market to its final close can be challenging, and as EMPEA's data suggest, this can be even more so for first-time managers. Entire service industries are built around this process, and every GP on the fundraising trail must make a number of strategic decisions that will shape their time in market, all driven by the quest to reach a fund's intended target as quickly as possible.

For first-time EM PE fund managers, the pool of available commercial capital is limited, making DFIs—which include supporting emerging managers as part of their mission—a primary source of funding (see Exhibit 15). Outside of DFIs, however, some family offices, pension funds, funds of funds and institutional investors have strong rationales to commit to first-time managers, and also have a history of doing so (see Exhibit 16). Their reasons to commit include, but are not limited to, access to new markets, access to the best-performing initial funds from a manager and access to subsequent funds from the most successful emerging managers. EMPEA Senior Advisor Kelly Williams remarks, "If investors decide they want emerging markets exposure, I believe they have to consider emerging managers. While past performances is not necessarily indicative of future results, in my opinion, a manager's best performance is frequently in his or her first or second fund. LPs realize that as long as they are comfortable with the investment thesis and the experience of a team, emerging managers can offer great investment opportunities." Another potential incentive for LPs to commit to a firm's first fund is the opportunity to commit to follow-on funds. Kelly Williams comments, "If a manager's first fund is very successful, it can be difficult for new LPs to access subsequent funds. That has certainly been the case in the U.S. in the last couple of years, and also in Asia with managers that have had a great deal of success."

While LPs of all types may have an incentive and even an aspiration to commit to the best and brightest emerging mangers, GPs operating in EM PE can face an uphill battle in securing these commitments. Notably, one important channel in developed markets for some emerging managers to access institutional capital is via emerging manager programs. However, as Kelly Williams comments, "Most emerging manager programs have been developed by U.S. institutions, and the vast majority that I am aware of are focused on domestic emerging managers." With emerging manager programs difficult to access for new firms that focus on EM PE, identifying LPs—both specific DFIs and other types of institutional investors—that have a rational and are willing to commit to emerging managers can be even more important. Armstrong Asset Management's Andrew Affleck emphasizes that identifying a list of realistic LPs was key to the success of his firm's first fundraise: "I concentrated on spending more time with a few key LPs that clearly back first-time managers and had a clear mandate for our sector. That was easier than going through a long process of trying to meet many and hoping to convince enough."

In identifying potential LPs, staying local can be helpful in kick-starting the fundraising process. "An African GP, for example, is likely to be more successful in their first fund if they raise money within their local market or their regional market as opposed to flying to Asia or the United States to raise money," says Avanz Capital's Haydee Celaya. Armstrong Asset Management's Andrew Affleck seconds this sentiment, noting: "Whatever your strategy is, geographically or sector-wise, if you are in the fortunate position to attract a local investor, that gives a great signal to any of your other potential investors. For us, as an Asia-focused firm, having a local investor that believed in the strategy was a big help when visiting potential LPs in Europe or the United States."

Finally, a fund manager's decision to use or not to use external advisors, such as placement agents, can define a firm's fundraising experience. For some emerging fund managers, prominent placement agents can facilitate crucial LP introductions and give GPs a stamp of legitimacy as they go out to market. For others that may already have deep networks in place, it may not make as much sense. But however a GP chooses to go about the fundraising process, there are numerous support services available. For a listing of EMPEA member placement agents and other service providers, please contact research@empea.net.

DFI Spotlight

"One thing that people consistently underestimate is the importance of the non-financial aspects of private equity to DFIs. It's great if a fund manager feels that they are very well-equipped to make some money in the next five years, but they need to show sensitivity to what is important to us, including impact and ESG. If you leave those words out of your strategy and your presentation, it will be a very short conversation. If you don't have the sensitivity to think through what the audience is actually looking for, then we're not going to spend a whole lot of time trying to help you build the required infrastructure."

–Erik Bosman, FMO – Netherlands Development Finance Company

"When we first started investing in venture capital funds, we were not interested in supporting established managers like Advent or Southern Cross, not because we don't like them—we felt they were very good—but because we wanted to support emerging managers. We looked for firms that didn't have a huge track record when they came to us, but that had potential."

–Susana Garcia-Robles, Multilateral Investment Fund of the Inter-American Development Bank

Exhibit 15: Sampling of DFIs Committed to First-time Funds Achieving a Final Close, 2012-Q1 2015

LP Name
African Development Bank (AfDB)
BNDES
CDC Group
Corporacion Andina de Fomento (CAF)
DEG
European Bank for Reconstruction and Development (EBRD)
European Investment Fund (EIF)
International Finance Corporation (IFC)
Multilateral Investment Fund (MIF)
Netherlands Development Finance Company (FMO)
Overseas Private Investment Corporation (OPIC)
Proparco
Swiss Investment Fund for Emerging Markets (SIFEM)

Source: EMPEA. Data as of 31 March 2015.

Exhibit 16: Sampling of Other LPs Committed to First-time Funds Achieving a Final Close, 2012-Q1 2015

LP Name
Adams Street Partners
Asset & Resource Management (ARM)
Case Foundation (Alps Investment)
Cisco
Corporacion Mexicana de Inversiones de Capital (Fondo de Fondos)
Google Foundation
Harry and Jeanette Weinberg Foundation
Morgan Stanley Alternative Investment Partners
Nomura Holdings
Omidyar Network
Pensionskassernes Administration A/S (PKA)
Soros Economic Development Fund (SEDF)
University of Texas Investment Management Company (UTIMCO)

Source: EMPEA. Data as of 31 March 2015.

Conclusion and Outlook

Over the last few years, the fundraising environment for first-time EM PE funds has become more challenging. As LPs have written bigger checks to larger, more experienced managers, the number and size of first-time funds has decreased. While in some respects, this decline can be viewed as the logical result of the erratic performance of first-time funds in 2000 through 2009 vintages, as well as the dramatic influx of new players and resulting saturation of the market in Emerging Asia, it is nonetheless troubling. Perhaps most concerning is that LPs appear to be overlooking earlier series funds—funds that are the first, second or third in a series—that both have the potential to deliver outsized returns and play an important developmental role in the industry at large. In many markets in which PE managers operate, small to mid-size companies make up the vast majority of businesses. With fewer funds on the small end of the market, many of which are first-time funds, fewer small and mid-sized companies will be able to benefit from the financing and other value adds—such as job creation and the implementation of environmental standards and international best practices—that are core to the investment strategies of many EM PE players. Moreover, early series funds have, at least historically, had the most attractive top quartile return profiles. For LPs aiming to achieve outsize returns and contribute to a more competitive and robust EM PE asset class, allocations to managers on their first, second or third fund may be considered alongside allocations to the most experienced and established sponsors.

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